THE FACTORS THAT CAUSE COMPANIES TO BE SUSPENDED FROM THE KUALA LUMPUR STOCK EXCHANGE*

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This is an empirical study of troubled (i.e., PN 4) companies, and their agency costs to outsiders who invest in them. The sample consisted of 21 companies each in three groups made up of PN 4, positive economic profit and negative economic profit companies. The study finds that outside investors in PN 4 companies incurred extreme agency costs compared to positive economic profit companies because of poor governance. Relative to the control group, PN 4 companies had higher insider ownership, borrowing, and lower equity values. The study highlights the uniqueness of the Malaysian securities law that allows corporate insiders to proactively use monitoring mechanisms to lower agency costs.

Keywords: *Troubled companies; corporate governance; Disclosures; Insider ownership*

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Introduction

The Asian financial crisis that started in 1997 adversely affected the performance of many East Asian economies, including Malaysia. This crisis created an environment whereby outside investors were vulnerable to expropriation by insiders (Francis et al. 2002). Consequently, outside investors became more sensitive to firms' corporate governance structures that they may have previously ignored (Rajan and Zingales, 1998). According to Mitton (2000), poor corporate governance in general and the lack of disclosures and transparency in particular, were contributing factors that exacerbated the Asian crisis. In East Asia, Malaysia is a unique case, partly because it rejected the International Monetary Fund (IMF) rescue package, since the restructuring proposed by the IMF would have resulted in greater foreign ownership of many local companies. Instead the then prime minister Dato' Dr. Mahathir Mohamad took steps to stabilise the economy by raising foreign debt from neighbouring countries, pegging the ringgit to the US dollar in September 1998, restricting the trading of Malaysian stocks outside of Malaysia, introducing a punitive tax for holding stocks for less than a year, and making the unofficial trading of the ringgit illegal (e.g., Poon, 1999). These actions have heightened the responsibilities of securities regulators to watch-out for the interests of outsiders, who could be taken advantage by insiders because they benefit disproportionately by the laws that promote a relationship-based capital market system.

In March of 1998, Malaysia proactively formed The Malaysian Institute of Corporate Governance (MICG), and a high-level finance committee to look into establishing a framework of corporate governance and setting a code of best practices for the listed companies. In 1999, this Committee developed the Malaysian Code of Corporate Governance to be administered by the MICG. The Code has been implemented since 2000 and it is backed by the listing rules of the Kuala Lumpur Stock Exchange (KLSE). The popular press in Malaysia taut the use of the best practices in corporate governance, and the enforcement of it by regulators as one of the ways to improve financial disclosures and promote transparent business reporting to serve minority shareholders. The dilemma for regulators would be to identify those governance practices that not only improve financial reporting but also contribute to increased firm profitability.

The regulators' focus on improving local company operations is important because one of the major criticisms of those who govern companies traded on emerging markets is that majority shareholders, who are closely associated with corporate insiders, act as if minority investors capital has no opportunity cost, hence, they do not feel obliged to provide a return on it (e.g., Chen et al., 2004; Lee, 2003). Consequently, Lee believes that a significant proportion of companies in emerging markets like Malaysia destroy economic value. For example, he cites KPMG and The Edge (a leading weekly business report published in Malaysia) finding that only 75 companies among the more than 800 companies listed on KLSE as at 31 December 2002 had a positive economic profit. Given this dismal performance of the majority of companies traded on the KLSE, the securities commission (SC) in Malaysia in 2001 decided to become more stringent, and began suspending poorly performing companies from trading on the KLSE.

In Malaysia, listed companies typically do not file for bankruptcy, instead they are temporarily suspended and given the chance to restructure before being allowed to trade again on the KLSE. The criterion for selecting poorly performing companies for evaluation are stated in the regulations referred to as Practice Note 4, as a result those companies chosen for delisting are called PN 4 companies. According to the regulation, if a company's shareholder equity is negative, and has received a going-concern qualification from the auditor or if receivers/special administrators have been appointed over one of its major subsidiary, then KLSE could classify it as a PN 4 company. Further, when KLSE begins de-listing procedures against a company (though it may not automatically mean that it will be permanently de-listed) it results in it being closely monitored by regulators. For example, the suspended companies have to regularize its financial condition, which is an essential first step in putting together a restructuring plan that has to be approved by the SC and the Companies Commission of Malaya.

The purpose of the study is to investigate whether factors such as governance, disclosure, financing, and growth are useful indicators to identify companies that are classified as PN 4 companies, and also to identify companies that are likely to be in trouble in the future. Specifically, it focuses on exploring these characteristics in the two groups (positive and negative economic profit) of companies versus the PN 4 companies, and suggests what regulators may consider as poor performance in a relationship-based capital market. The objective is to understand what SC in Malaysia is doing to improve the quality of the companies traded on KLSE, and see how well it is working to protect outside shareholders. As of 30 June, 2004 about 125 companies have been classified as affected issuers, but this study focuses on 21 companies that have been suspended from trading (http://www.bursamalaysia.com/website/listing/pn4cos.htm). However, unlike the rest, the 21 PN 4 companies chosen have had their restructuring plans approved by regulators, which paves the way for them to apply to resume trading. The investor confidence in the PN4 companies is at is lowest when they are classified as such by regulators. Therefore, the companies need to find ways to improve, not only their financial condition but also the liquidity of their stocks, so that they can eventually begin to trade on KLSE (Oh, 2003a). One would expect that the PN 4 companies compared to the rest would have the weakest corporate governance and disclosure practices before the restructuring processes, and the regulators would expect these companies to put in place mechanisms to improve them. The study uses agency theory and the Malaysian institutional background to develop and test four hypotheses.

The study finds that a good corporate government mechanism such as having a compensation committee and duality of the role of chairman of the board versus the company CEO helps to differentiate companies that generate a positive economic profit from the PN 4 companies. Interestingly, we find that firms trading on the KLSE are more likely to increase their level of disclosures after they perform poorly than before. Additionally, poor debt management and asset growth are also probable causes that bring increased attention from securities regulators to these companies. The study argues that this increased monitoring by regulators can be viewed as another means of reducing the extreme agency costs to outsiders who invest in these troubled companies.

Literature Review

La Porta et al. (2000) defines corporate governance as a set of mechanisms through which outside investors protect themselves against expropriation by corporate insiders. The degree of expropriation by insiders depends on the investment opportunities available and the cost of expropriation to the firm. Johnson et al. (2000) and Durnev and Kim (2003), suggest that insiders expropriate more when the market is bad, and take less when the market is good. These authors argue that one could address the agency problem between outsiders and corporate insiders by imposing a higher cost on expropriation by using good corporate governance practices, which may help improve the association between the degree of expropriation and the market condition. Lombardo and Pagano (2000) note that outside investors demand a lower rate of return from firms with better corporate governance because they need to spend less time and resource monitoring the management of the company. Hung and Trezevant (2003) find that better corporate governance is associated with less insider trading in Southeast Asia. Specifically, they note that the firms controlled by the richest families were the most aggressive in trading on their proprietary knowledge.

Corporate governance mechanisms are particularly important in countries like Malaysia that have chosen to promote relationship-based capital market systems that suppress the free market price systems and the signals they provide (e.g., Rajan and Singales, 1998). Moreover, research has shown that the Malaysia's response to the Asian crisis favored listed companies that were aligned with Prime Minister Dr. Mahathir than with the Deputy Prime Minister (Johnson and Mitton, 2003). Therefore, in order to promote investments by minority domestic investors and foreign investors, security regulators in Malaysia have a greater vested interest to have regulations that protect the interest of outsides from expropriation by insiders. Further, the setting up of the institutions like the MICG and PN 4 regulation could be viewed as the means used by the government to identify companies with poor governance and operations, which have to be dealt with before a crisis worsens in order to maintain and improve investor confidence. These arguments lead to the first hypothesis that:

H1: Poor corporate governance is a significant factor that explains regulators decision to suspend companies from the KLSE.

Empirical evidence has shown that the presence of non-executive directors on the board affects the financial performance of companies. Non-executive directors (NED) on the board are seen as the check and balance mechanism that enhances a board's effectiveness. This is because NEDs have a different set of incentives than executive directors, stemming directly from their responsibilities as directors and augmented by their equity position (Mangel and Singh, 1993). Fama and Jensen (1983) and Mak (1996) also agree with the contention that NEDs play their roles as monitors of management's performance. Furthermore, NEDs are also considered to be 'decision experts' (Fama and Jensen, 1983), independent and not intimidated by the chief executive officer (Weisbach, 1988), able to reduce managerial consumption of perquisites (Brickley and James, 1987), and act as a positive influence over directors' deliberations and decisions (Pearce and Zahra, 1992). On the other hand, the shortcomings of a high proportion of NEDs on boards include stifling strategic actions (Goodstein et al, 1994), excessive monitoring (Baysinger and Butler, 1985), lack of business knowledge to be effective (Patton and Baker, 1987) and lack of real independence (Demb and Neubauer, 1992).

Just like in developed economies, in Malaysia board of directors are composed of executive and non-executive directors. Therefore, board composition could be an important variable that regulators consider, because it will indirectly reflect the role of NEDs, which is, more disclosures. For instance, a Malaysian study by Hanifa and Cooke (2002) found significant association between voluntary disclosure levels and NEDs/chairman of the board. As such, strengthened corporate governance and reporting practices, and the improved credibility of financial information that should result, may not eliminate business failure in totality, but could provide the "red flag" signals to the regulators. Hence, as with past studies, the level of disclosure is considered complimentary governance mechanism that outside investors demand a lower rate of return from firms with better corporate governance because they need to spend less time and resource monitoring the management of the company. Hung and Trezevant (2003) find that better corporate governance is associated with less insider trading in Southeast Asia. Specifically, they note that the firms controlled by the richest families were the most aggressive in trading on their proprietary knowledge.

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H2: The amount of corporate disclosures is a significant factor that explains regulators decision to suspend companies from the KLSE.

A study by Bushman et al., (2004) has found that high ownership concentration and board structure are not independent, and that these governance variables are related to earnings timeliness and organizational complexity. Specifically, their study shows that limited transparency and complexity of firms' operations increase the demand for governance mechanisms such as high ownership concentration. This they argue, helps to reduce the moral hazard problems between insiders and outsiders. In a Malaysian study, Abdual Rahman and Haniffa (2003) found that outside shareholding is an effective mechanism for monitoring performance. This leads us to hypothesize that ownership concentration will be high in poorly performing firms that disclose less. Generally, the research in emerging markets has shown that outsiders realize that managers and families routinely employ pyramid ownership structures to give themselves control rights to companies that far exceed their proportional cash flow rights (for a review see Denis and McConnell, 2003).

Agency theory suggests that with complex ownership structures, managers and insiders may show their willingness to be monitored by creditors such as banks by increasing their borrowing (Harvey et al. 2003; Diamond, 1991; Ross, 1977). Specifically, Harvey et al's (2003) study finds that in emerging markets, when a firm has extreme information asymmetry between corporate insiders and outsiders, the company may use debt borrowed in international markets to signal their willingness to be monitored by lenders. The later can then serve as a mechanism to correct the misaligned managerial incentives too. On the other hand La Porta et al. (2003) argue that domestically issued short-term debt is less likely to discourage corporate insiders, because family groups or governments typically control the banks and can use debt to further their own ends. Unless they are government-linked firms, the Malaysian companies typically do not have cosy relationships with their bankers. The PN 4 companies identified to date do not have any apparent links to the government, hence, given the need for capital to finance growth and the high agency costs to outside equity investors, it is possible that corporate insiders will seek to raise a large amount of debt capital. Whether or not such an action helps to reduce the moral hazard problems is an empirical issue that will be discussed based on our findings. This leads to our third hypothesize that:

H3: The means used to raise capital, namely the amount of equity versus debt financing, is a significant factor that explains regulators decision to suspend companies from the KLSE.

The board-level committee such as the audit committee and the duality of the role of the chairman of the board and CEO have been found to be important governance variables. It has been suggested that the reputation of the external auditor may be an important variable that affects audit committees effectiveness (e.g. Dechow, Sloan, and Sweeney, 1996). A survey by MICG, IIAM and Ernst & Young (2000) encompassed all public listed companies on the KLSE and Mesdaq found that 99 percent of over 120 respondents complied with the mandatory requirements of having an audit committee with a minimum of two-thirds non-executive directors in them. The issue in Malaysia has been that the audit market is subject to fee regulation; hence, studies have found that Big Five auditors discount audit fee if the client's controlling shareholders possessed effective control (Fan and Wong, 2001). Therefore, the outsiders may not consider the appointment of Big Five auditors as an effective monitoring mechanism, and other means to strengthen the audit committee may be important.

An equally important board-level committee is the compensation committee whose main responsibility is to monitor top management, particularly the CEO compensation package (Murphy, 1985). According to Murphy this committee's effectiveness is moderated by the role of managerial labor markets. Renneboog and Trojanowski (2002) find that the presence of a remuneration committee had no significant impact on top management remuneration. This result may be due to the fact that their study was conducted on a sample of companies listed on the London stock exchange. Malaysia, unlike England, does not have a well developed labor market. Therefore, one could argue that compensation committees, particularly in troubled companies, can play a critical role by rewarding management by using pay-for-performance contracts.

One of the key measures of managerial performance and compensation is the managers' ability to develop and implement strategies that ensure long-run firm growth. Tobin's Q ratio is a measure of a firm's growth opportunities, capturing the effects of a company's investment strategies. This implies that the greater the real return on investment, the greater the value of Q. Lindberg and Ross (1981) suggest that ranking firms on the Q values is similar to ranking them on the basis of expected future cash flows. In a study to identify over-investment in industries that had limited investment opportunities, Berger and Ofeck (1995) used Tobin's Q. Using a similar approach, Lang and Stultz (1994) found that highly diversified firms have significantly lower mean and median Q ratios than narrowly diversified firms. These studies suggest that management can influence performance governance by affecting the sales growth and asset growth of their companies. Therefore, our fourth hypothesis compares PN 4 companies versus those companies that earn a positive economic profit, and it states that:

H4: The availability of growth opportunities to companies is a significant factor that explains regulators decision to suspend companies from the KLSE.

Our view is that it is the combination of poor corporate governance, weak disclosures, and extreme use of debt and low growth opportunities that drive regulators to take all the 'red flag' together and consider classifying them as PN 4 companies. This extreme action is taken not only to protect the outside shareholders of the PN 4 companies but also to send a warning to the other poorly performing companies. Thus, in addition to comparing the PN 4 companies to the best companies, it would be important to compare them to those companies that are likely to fail in the near future.

Sample Selection

The sample consists of 63 companies of which 21 were classified as PN4 companies, 21 companies have negative economic profit in 2002, and another 21 comparable companies have a positive economic profit in 2002. The 42 companies with negative and positive economic profits were chosen as control groups for the PN 4 companies. They were first matched by either a positive or negative economic profit as stated in the 2002 KPMG/The Edge's shareholder value awards 2002 (Lee 2003), secondarily they were matched by the industry to which they belonged and then by the closeness to the size, that was measured by the total assets of the chosen PN4 companies. Additionally, the 21 companies selected for this study have had their restructuring plan approved by the authorities between January 2002 and May 2004. Upon approval, these companies were released from their PN 4 classification and their trade restrictions were lifted, which means they can reapply to the SC to have their stock traded.

According to the regulations, Practice Note 4 that took effect on February 15th 2001, a listed company that fulfils one or more of the criteria in listing requirements are referred as "an affected listed issuer." After being classified under PN 4, an affected listed issuer must make an announcement to the KLSE of a plan to regularize its financial condition within seven days from the date of this Practice Note or from the date a listed issuer fulfils one or more of the criteria prescribed above. Following this disclosure, the company has a maximum period of six to twelve months to submit its restructuring plan to the relevant authorities for approval, including the SC. Then, it must obtain all approvals necessary for the implementation of such a plan within four months from the date of submission. The paragraph 8.14(2) of the listing requirements prescribes the following criteria, the fulfilment of one or more of which will require a listed company and/or its directors to comply with the provisions of this Practice Note:

a. Deficit in the adjusted shareholders' equity of the listed issuer on a consolidated basis;
b. Receivers and/or managers have been appointed over the property of the listed issuer, or over the property of its major subsidiary or major associated company which property accounts for at least 70 per cent of the total assets employed of the listed issuer on a consolidated basis;
c. The auditors have expressed adverse or disclaimer opinion in respect of the listed issuer's going concern, in its latest audited accounts; or
d. Special administrators have been appointed over the listed issuer or the major subsidiary or major associated company of the listed issuer pursuant to the provisions of the Pengurusan Danaharta Nasional Berhad Act 1998 (in English "National Asset Management Limited Act 1998.").

Measurements and Methodology

Economic Profit Measure

The KPMG/The Edge's shareholder value awards are given based on their ranking of Malaysian companies' economic value management, which requires the computation of economic profit for companies listed on the KLSE. The calculation of economic profit integrates three aspects of business economics, namely, Net Operating Profit after Tax (NOPAT), Invested Capital (IC) and Cost of Capital. The NOPAT figure was derived from after-tax net operating profits in order to reflect a true income stream rather than a book-accounting stream. The NOPAT figures used were basically earnings before interest, tax and amortization (EBITA) less adjusted taxes. To compute the IC of a company, an average of its FY2001 closing book values of total debt and total equity and its FY2002 book values of total debt and total equity was used. The cost of capital is calculated based on its specific weighted average cost of capital, which, in turn, is derived using the weight each company has in terms of its market values of debt and equity. According to the publishers of the business newsletter – The Edge, to calculate weighted average cost of capital in 2002 the risk free rate used was 3.5%, and the average risk premium added to obtain the expected market rate of return was around 4.5%. The key measure by which the companies were ranked in this study was economic profit, which is EBITA less weighted average cost of capital of IC. Lee (2003) emphasized that EP/IC is used because it would remove the distortion caused by difference in company size and could be used to rank companies based on economic profits[1].

Corporate Governance Measures

The role of NEDs on the board of a company was measured by the number of these individuals divided by the total number of directors on the board before restructuring. The Cadbury Report recommended that all quoted companies should establish internal board sub-committees including a compensation committee and an audit committee. The Report particularly argues that audit committees are an important control mechanism that ensures that shareholder interests are safeguarded (Cadbury, 1992)[2]. The Cadbury Report argued that the effectiveness of an audit committee depends in part on the quality of the non-executive (and hopefully independent) members in it. The quality of audit committee members is measured by the amount of independent non-executive directors on the audit committee before restructuring.

Good substitute for internal governance is the quality of the external auditor, extent of non-family ownership, and the number of foreign mutual fund companies that have an interest in these companies. It is believed that the quality of an audit is higher if a company is being audited by any one of the Big Four public accountants relative to those audited by smaller firms. Information on the percentage of shares held by family members and insiders is used as a reverse measure of non-family ownership, and we refer to this as insider ownership. The annual reports of the companies provide information about the percentage holding of the top thirty shareholders as well as percentage holding by individual directors, which was used to compute the percentage of insider ownership.

Valuation Measures

Tobin's Q is a widely used measure to capture the success of the corporate governance, and to predict the future success of companies (e.g., Weir et al., 2002; Lindenberg and Ross, 1981). It compares the market value of the firm with the replacement cost of the firm's assets. It implies that the greater the value of Q, the greater the real return on investment. For our study, instead of using an aggregate measure we utilized the individual components of Tobin's Q and the factors that have been found to affect it. The components include the firm's market value, which is measured by the market value of common stock, plus the market value of long term bonds and the book value of preferred stock. The equity market value is the number of outstanding shares times the price per share, and debt value of all companies is equal to the total book value of all long term debt at the end of the fiscal year 2002. The market value of debt could not be obtained because all these companies had obtained private loans. The total assets and liabilities were determined from the annual reports that were published before the approval of the company restructuring plans. This approach allowed us to use numbers that would not be affected by the extensive restructuring these companies would have undertaken to obtain approval to be re-listed on KLSE. Given the importance of sales and asset growth for companies in dire straits, we also included these variables as separate factors that might help predict companies poorly managed growth. Growth was measured by the difference in the book value of assets (or sales) in the year before (t) and the year preceding the year of (t-1) restructuring.

Disclosure Index

The corporate governance reporting model developed in the current research is based upon factors identified in national and international best practice guidelines and other research studies[3]. The model considers objective factors based on publicly disclosed information. Corporate governance factors are generally divided into two main categories: basic corporate governance variables are those items specifically identified by the Code, and quality corporate governance variables are value-added items generally proposed by other best practices worldwide. It is worth to note that the ultimate objective of this corporate governance rating exercise is to encourage the firms to uphold the 'substance over form' principle of governance rather than merely a 'box-ticking' process of compliance with statutory regulation.

In this study, unlike the self-assessment questionnaire designed by the Forum for Corporate Governance in Indonesia (2001), and the voluntary disclosure index by Haniffa and Cooke (2002) and corporate governance questionnaire used in Saldana's (2000) study which only provided a dichotomous scale of a "yes" or "no" options, our study's checklist is designed so that every individual disclosure is evaluated based on a five point of Likert scale. We measure the level of corporate governance reporting based on the extent to which companies disclose the relevant information in their annual reports. It classifies the contextual factors into eight major groups that simultaneously emphasize the duality of practicability and world-class quality reporting goals. However, to keep our disclosure index comparable to those used in prior studies, we focused only on the accountability and transparency measures, which include both voluntary and mandatory disclosure requirements that are accounting related (See appendix A).

Methodology

In this study the dependent variable is dichotomous; for the first model, those classified as PN 4 companies were coded as 1 and the positive economic profit or good companies were classified as 0. For the second model, those companies classified as PN 4 companies were coded as 1 and the negative economic profit companies were coded as 0. Additionally, the independent variables as measured above are mostly nominal values; hence, we used log-linear models and logistic regression analysis to test our hypotheses. Additionally, we used a backward stepwise log-liner regression selection method in order to find a model that is parsimonious, fits the data well and most importantly make substantive sense (given the many factors and the correlations between them)[4]. Consequently, as we progressed from the governance factors (including the disclosure index) to the valuation factors we only retained those variables that were significant in each category in the logistic regression, and the tables also report the variables that did not enter the model.

Results

Table 1 show the descriptive statistics for each group of companies separately. Compared to the two control groups, the PN 4 companies have a significantly higher insider ownership (at the 0.01 level). Furthermore, compared to the companies with positive economic profit the PN 4 companies have significantly higher sales, debt, and lower equity values. Based on these univariate statistics, a cohesive business story would be that the PN 4 companies' corporate insiders have grown their sales with lower equity base, and using more debt capital. This poor financial management combined with the agency issues probably have landed them in trouble compared to positive economic profit companies in the same industry. Panel A in both Tables 2 and 3 confirm this, with the insider ownership being the most significant (at the 0.05 level) predictor, followed by the number of non-executive directors on the audit committee (marginally significant at the 0.08 level) of PN 4 firms versus the other two group of companies. Hypothesis H1 stated that poor corporate governance would be a significant factor that explains regulators decision to suspend companies from KLSE. Table 2, Panel A also shows that compared to well-managed companies, both the presence of a compensation committee and role duality are key corporate governance mechanisms that could be used by regulators to classify companies under the PN 4 regulations. More importantly, these two governance mechanisms were lacking in the companies that had negative economic profits, which are probably closer to meeting the criteria for PN 4 status than the positive economic profit companies.

Using these governance variables, the governance model in Table 2 correctly classifies 18 out of the 21 companies with positive economic profit, and 17 out of the 21 PN 4 companies, with an overall classification accuracy of 83%. The governance model in Table 3 correctly classifies 16 out of the 21 companies with negative economic profit and 15 out of the 21 PN 4 companies, which is an overall classification accuracy of 74%.

Interestingly, the correlation results in Table 4 suggest that as the companies go from positive profit to negative profit to PN 4 companies, the association between non-executive directors on the board to non-executive directors on the audit committee goes from lacking in significance to being significant. Thus, contrary to our expectations, the PN 4 and the negative economic profit companies have more non-executive directors on the audit committee. Given the audit environment in Malaysia, this probably illustrates how proactively insiders act to rectify poor audits by strengthening the audit committees. Having more of the non-executive directors who serve on the board also serve on the audit committee is probably one of the easiest improvements in governance a company can make this will show the outsiders that the company is serious of being monitored to lower its agency costs to raise capital. Thus, we conclude that there is strong support for

Table 1: Comparison of Company Descriptive Statistics
(Mean and (Standard Deviation))

Governance Factors	Positive Econ. Profit	PN 4 Companies	Negative Econ. Profit	Pos. vs. PN4 t-test/z-test	Neg. vs. PN4 t-test/z-test
Inside Own.	41%	68%	27%	0.01	0.01
	(27%)	(33%)	(21%)	0.01	0.00
Non Exc.-BOD	62%	57%	56%	0.39	0.86
	(15%)	(23%)	(18%)	0.84	0.59
Non Exc. –	69%	74%	70%	0.24	0.39
Audit Committee	(11%)	(17%)	(10%)	0.84	0.98
Role Duality	20	13	15	0.01	0.52
				0.19	1.00
Big 4 Audit	13	13	13	1.00	1.00
				1.00	1.00
Comp. Comm.	16	7	5	0.00	0.51
				0.04	1.00
Disclosure Index	41%	46%	50%	0.09	0.10
	(7%)	(9.1%)	(8.8%)	0.35	0.35
Valuation Factors					
Assets (millions)	R 554	R 919	R 917	0.31	0.99
	(609)	(1520)	(2164)	0.59	0.98
Sales (millions)	R 787	R3392	R 330	0.39	0.32
	(1339)	(13834)	(517)	0.01	0.84
Asset growth	8.25%	0.01%	0.02%	0.59	0.79
	(0.44%)	(0.45%)	(0.42%)	0.02	0.84
Sales growth	3.14%	17.80%	0.74%	0.63	0.74
	(0.34%)	(1.36%)	(0.47%)	0.36	0.59
Equity Mkt.	R 873.24	R 83.17	R 860.59	0.10	0.10
Value (millions)	(2248.79)	(94.85)	(2767.13)	0.00	0.01
Debt Amt.	R 184.92	R 620.96	R 247.04	0.090.09	0.340.84
(millions)	(496.52)	(1648.53)	(707.98)		

Table 2: Comparing PN 4 Companies Vs Positive Economic Profit Companies

Panel A – Logit Model Incorporating Governance Factors

Variable	B	S.E.	Wald	df	Sig
Inside Own.	0.04	0.02	4.39	1	0.04
Non Exe. Audit	10.48	4.79	4.77	1	0.03
Comp. Committee	- 2.79	1.31	4.59	1	0.03
Duality	- 3.55	1.74	4.17	1	0.04
Disclosure	15.77	6.82	5.34	1	0.02
Constant	-11.56	4.56	6.42	1	0.01
		Chi-Square		df	Sig
Model Chi-Square		29.30		5	0.00
Step Improvement		- 0.55		1	0.46

Variables removed at iteration number five were: non executive directors on the board and Big 4 auditors.

Panel B – Logit Model Incorporating Financing and Valuation Factors

Variable	B	S.E.	Wald	df	Sig
Inside Own.	0.20	0.11	3.02	1	0.08
Equity Value	- 0.09	0.05	2.94	1	0.08
Debt Value	0.17	0.05	5.12	1	0.05
Asset Growth	5.27	5.01	1.10	1	0.29
Constant	- 1.61	2.34	0.47	1	0.49
		Chi-Square	df	Sig	
Model Chi-Square		47.67	4	0.00	
Step Improvement		-0.01	1	0.91	

Variable removed at iteration number twelve was sales growth.

Table 3: Comparing PN 4 Companies Vs Negative Economic Profit Companies

Panel A - Logit Model Incorporating Governance Factors

Variable	B	S.E.	Wald	df	Sig
Inside Own.	0.06	0.00	9.56	1	0.02
Non Exe. Audit	6.13	3.45	3.15	1	0.08
Constant	-7.03	3.00	5.48	1	0.02
		Chi-Square		df	Sig
Model Chi-Square		20.83		2	0.00
Step Improvement		- 2.00		1	0.16

Variables removed at iteration number four were: non executive directors on the Board, compensation committee, Big 4 auditors, role duality, and disclosure index.

(cont.) Table 3: Comparing PN 4 Companies Vs Negative Economic Profit Companies

Panel B - Logit Model Incorporating Financing and Valuation Factors

Variable	B	S.E.	Wald	df	Sig
Inside Own.	0.13	0.07	3.82	1	0.05
Equity Value	0.06	0.03	3.63	1	0.06
Debt Value	0.13	0.68	4.69	1	0.03
Constant	- 2.02	1.59	1.61	1	0.20

	Chi-Square	df	Sig
Model Chi-Square	42.62	3	0.00
Step Improvement	-2.02	1	0.15

Variable removed at iteration number eleven were asset growth and sales growth.

	Chi-Square	df	Sig
Model Chi-Square	47.67	4	0.00
Step Improvement	-0.01	1	0.91

Variable removed at iteration number twelve was sales growth.

Table 4: Correlation Profiles

Panel A - Positive Economic Profit Companies

	In Own	NED BOD	NED Audit	Asset Growth	Sales Growth	Equity Value	Debt Value	Comm. Comte	Dis. Index
In Own	1.00								
NED BOD	-0.27 (0.11)	1.00							
NED Audit	0.07 (0.38)	0.07 (0.38)	1.00						
Asset Growth	-0.70 (0.38)	-0.21 (0.19)	-0.21 (0.45)	1.00					
Sales Growth	-0.22 (0.17)	0.12 (0.30)	0.10 (0.33)	0.51*** (0.01)	1.00				
Equity Value	-0.38** (0.04)	-0.07 (0.38)	-0.08 (0.36)	-0.05 (0.41)	0.02 (0.47)	1.00			
Debt Value	-0.16 (0.25)	-0.25 (0.14)	-0.08 (0.36)	-0.45** (0.02)	-0.38** (0.04)	0.36* (0.06)	1.00		
Comm. Comte	0.03 (0.44)	-0.50** (0.02)	0.05 (0.41)	-0.05 (0.42)	0.04 (0.43)	0.18 (0.22)	0.17 (0.23)	1.00	
Dis. Index	-0.48** (0.02)	0.21 (0.18)	0.18 (0.22)	-0.11 (0.32)	001 (0.48)	0.30* (0.09)	0.10 (0.33)	0.40** (0.04)	1.00

(Cont.) Table 4: Correlation Profiles

Panel B – Negative Economic Profit Companies

	In Own	NED BOD	NED Audit	Asset Growth	Sales Growth	Equity Value	Debt Value	Comm. Comte	Dis. Index
In Own	1.00								
NED BOD	-0.52*** (0.01)	1.00							
NED Audit	-0.39 (0.04)	**0.46** (0.02)	1.00						
Asset Growth	-0.26 (0.13)	-0.09 (0.34)	-0.19 (0.21)	1.00					
Sales Growth	-0.27 (0.12)	0.30* (0.09)	0.21 (0.19)	0.63*** (0.00)	1.00				
Equity Value	-0.28 (0.11)	0.30** (0.09)	-0.04 (0.42)	0.01 (0.49)	0.14 (0.17)	1.00			
Debt Value	-0.29* (0.10)	0.33* (0.08)	-0.11 (0.31)	-0.03 (0.45)	0.18 (0.22)	0.98*** (0.00)	1.00		
Comm. Comte	-0.34* (0.07)	0.58** (0.01)	0.19 (0.19)	-0.07 (0.38)	0.05 (0.42)	-0.11 (0.32)	0.07 (0.37)	1.00	
Dis. Index	-0.11 (0.32)	-0.21 (0.18)	-0.16 (0.24)	0.40** (0.04)	0.20 (0.19)	0.06 (0.41)	0.10 (0.33)	0.10 (0.34)	1.00

Panel C – PN 4 Companies

	In Own	NED BOD	NED Audit	Asset Growth	Sales Growth	Equity Value	Debt Value	Comm. Comte	Dis. Index
In Own	1.00								
NED BOD	-0.12 (0.31)	1.00							
NED Audit	-0.19 (0.21)	0.29* (0.10)	1.00						
Asset Growth	-0.27 (0.16)	-0.17 (0.23)	-0.13 (0.28)	1.00					
Sales Growth	-0.04 (0.44)	0.30 (0.45)	0.21 (0.19)	0.22 (0.16)	1.00				
Equity Value	0.13 (0.29)	0.042 (0.43)	0.17 (0.23)	0.01 (0.48)	0.83*** (0.00)	1.00			
Debt Value	0.15 (0.26)	0.01 (0.49)	0.03 (0.45)	-0.03 (0.46)	0.17 (0.23)	0.17 (0.23)	1.00		

(Cont.) Table 4: Correlation Profiles

Comm. Comte	-0.14 (0.28)	0.27 (0.12)	0.20 (0.19)	-0.10 (0.34)	-0.12 (0.29)	-0.02 (0.46)	0.33* (0.07)	1.00	
Dis. Index	0.11 (0.32)	0.05 (0.42)	0.04 (0.43)	-0.31* (0.08)	0.06 (0.41)	0.11 (0.32)	-0.07 (0.38)	0.03 (0.44)	1.00

*** Significant at the 0.01 level
** Significant at the 0.05 level
* Significant at the 0.10 level

H1; certain corporate governance mechanisms play an important role in emerging markets, which in turn can contribute to improved operations and economic profits.

Hypothesis H2 stated the amount of corporate disclosure would significantly explain regulators decision to suspend companies from KLSE. Tables 1 and 2 (Panel A) finds evidence to the contrary, the PN 4 companies disclose significantly (at the 0.09 level) more than the good companies. This should not be surprising because the corporate insiders in the PN 4 companies would have anticipated to being closely monitored, and hence, taken steps such as strengthening the audit committee and increasing the amount of disclosures. It is interesting that the volume of their disclosures is not significantly different than that of the negative economic profit companies, which have the highest amount of disclosures. Therefore, though there is no support for H2, the results support the notion that when problems of moral hazards increase, the corporate insiders and regulators consider disclosures to be an alternative governance mechanism that can improve monitoring by outsiders.

Hypothesis H3 stated that the means used to raise capital would be a significant factor that explains regulators decisions to suspend companies from KLSE. Table 2 Panel B, shows evidence that support this hypothesis. The PN 4 companies have significantly higher (at the 0.05 level) amount of debt compared to the good companies. The model in this table also supports the view that this combination creates extreme agency costs, which significantly (at the 0.08 level) depresses the equity value of the PN 4 companies relative to the well managed companies. Table 3 Panel B, also provides evidence that supports hypothesis H3, and reinforces the agency cost explanation for the depressed equity values of PN 4 companies. As per the results, the PN 4 companies have significantly higher insider ownership and debt (both at the 0.05 level), and significantly lower (at the 0.06 level) equity values compared to the negative economic profit companies. Therefore, the extreme agency costs being the reason why PN 4 companies are in trouble is strong.

The final hypothesis H4 stated that the availability of growth opportunities to companies is a significant factor that explains regulators decisions to suspend companies from the KLSE. When comparing PN 4 companies versus the positive economic profit companies, there is partial evidence to support this hypothesis. Table 2 Panel B shows that asset growth is an important predictor of PN 4 companies versus the good companies; such evidence does not exist when comparing PN 4 companies to the negative economic profit companies[5]. Interestingly, Table 4 correlations show that, unlike the rest of the companies, well-managed companies do not rely on debt to grow their assets either.

Conclusion

Malaysia is probably the only country where companies are temporarily suspended from trading, and given a second chance. This gave us an opportunity to explore how and why the suspended (or PN 4) companies got themselves into trouble. Particularly, we investigated how the corporate governance mechanisms including weak disclosures and poor growth management may have raised the 'red flags' among the securities regulators, bringing about more monitoring to reduce the agency costs to outside shareholders. In order for comparisons with troubled companies to be made, we created three groups; companies with positive economic profit, negative economic profit, and the PN 4 group of companies. In the literature review, we argued that the later two groups that had destroyed shareholder value had governance structures that were less optimal than companies generating positive economic profits. The arguments were based on agency theory studies that have shown that limited disclosures about the clarity of company activities and performance increases the demand on corporate governance systems to alleviate moral hazard problems that result from the information gap between managers, corporate insiders and outside shareholders (e.g., Bushman et al., 2004; Hermalin and Weisbach, 2003; and LaPorta et al., 1998; 2003).

We suggest that the poor corporate governance combined with extreme amounts of debt and poor growth management was the recipe for trouble, which in-turn may attract regulators, attention. To test this proposition, we developed four hypotheses and tested it using secondary data. We found that corporate governance mechanisms such as role duality and board compensation committee created value for companies traded on the KLSE. More importantly, we found that companies in trouble tend to appoint non-executive directors on the board to the audit committee to reduce agency costs, and increase their disclosures. Additionally, PN 4 companies also carried the heaviest debt burden and incurred the extreme agency costs in terms of the lowest equity values. Thus, being subject to be monitored by regulators is probably one of the ways of showing willingness to reduce the agency costs to minority shareholders by engaging in asset and debt restructuring.

The study's contribution is that it reinforces the findings of previous research, showing the importance of good corporate government mechanisms for creating value for minority shareholders in emerging markets. It also highlights how insiders of poorly performing companies use some of the governance mechanisms, including disclosures, to lower costs of raising debt and equity. Regulators can perform their monitoring tasks more effectively if they proactively monitor the combined 'red flags' such as misaligned asset and sales growth, poor corporate governance, weak disclosures and the debt burden of listed companies. A recent article by Shanmugan and Siow (2004) reported that YCS Corp Bhd., which was a PN 4 company whose restructuring plan was approved and had begun trading on KLSE, was reclassified again in the PN4 list two years after completing its restructuring, because it defaulted on interest payments. It happens to be that the examples of PN 4 companies restructuring failures given by Shanmugan and Siow were using debts as the major source of finance in their original restructuring, and many such companies continued to have below par share prices. This finding lends credibility to La Porta et al's. (2003) suggestion that restructuring by issuing short-term private debt in capital markets that inhibit price signals are not likely to provide confidence to outsiders, and help reduce the moral hazard problems. We encourage future research to test the validity of factors that improve long-term performance governance under different market, institutional, and regulator settings.

Our findings are limited because of the small sample of PN 4 companies we were able to study, and the corresponding limited control firms we used to compare them to. Unfortunately, the laws suspending companies from trading is new, and there are not many companies on the KLSE that generate a positive/negative economic profit with similar characteristics to draw from as a control group either. This also limits the possibility of using widely used tools such as Tobin's Q to compare and contrast firms that are significantly different in terms of value creation. Despite these limitations, given the lack of strong bankruptcy laws in many emerging markets to protect outsiders, it is important to conduct studies to investigate interdependent factors that strengthen or weaken price signals in less than efficient capital markets.

Notes

1 We chose this measure over commonly used measures of Tobin's Q to rank companies because few companies in our sample had negative net worth.

2 Para. 13.8.1 of the KLSE Listing Requirement requires all listed companies to have an audit committee with at least three members shall comprise independent directors.

3 These include OECD White Paper on Corporate Governance in Asia (2003); the IFAC Credibility Report (2003); Australian Stock Exchange's Principles of Good Corporate Governance and Best Practice Recommendations (2003); Standard & Poors (2000); Credit Lyonnais Securities Asia, 2001; Blue Ribbon Committee Report of USA (1999); Ernst and Young's Report on Corporate Governance (2002); and the Malaysian Code of Corporate Governance (2000).

4 According to Demaris (1992), under this method all variables are initially entered and then at each step variables are evaluated for removal, and the removal testing is based on the probability of the likelihood-ratio (LR) statistic based on the maximum-likelihood estimates. The higher the -2Log LR the more likely the variable will not be removed.

5 We performed logistic regressions that included governance, financial, and valuation variables together in a model. Similar to Table 4 Panel B, Insider ownership was the only governance variable along with debt and equity value that help predicts these two groups. However, we were not successful in comparing PN 4 versus good companies with all variables in a single model because after twenty iterations it failed.

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Appendix A

		Level 5	4		Level 3	2		Level 1
5.0					ACCOUNTABILITY AND TRANSPARENCY			
a.	☐	External auditors, scope and nature of external audit and major findings of external audit investigations are sufficiently disclosed	☐	☐	Notes on external auditors, scope and nature of external audit and major findings of external audit investigations are fairly disclosed	☐	☐	Notes on external auditors, scope and nature of external audit and major findings of external audit investigations are not disclosed
b.	☐	Financial calendars are sufficiently outlined	☐	☐	Notes on financial calendars are fairly outlined	☐	☐	Notes on financial calendars are not outlined
c.	☐	Information on non-audit fees are fully disclosed	☐	☐	Notes on non-audit fees are fairly disclosed	☐	☐	Notes on non-audit fees are not disclosed
d.	☐	Notes on accounting policies and related principles are explained in detail	☐	☐	Notes on accounting policies and principles are generally explained	☐	☐	Notes on accounting policies and principles are not explained
e.	☐	Notes on interim review of the accounting system are sufficiently disclosed	☐	☐	Notes on interim review of the accounting system are only generally disclosed	☐	☐	Notes on interim review of the accounting system are not disclosed
f.	☐	Notes on industry norms, both inter-company and intra-company comparisons are sufficiently reported	☐	☐	Notes on industry norms, both inter-company and intra-company comparisons are fairly reported	☐	☐	Notes on industry norms, both inter-company and intra-company comparisons are not reported
g.	☐	The company has sufficiently disclosed its forecast on major financial	☐	☐	The company has fairly disclosed its forecast on major financial and non-financial matters	☐	☐	The company has not disclosed its forecast on any financial and non-financial matters

(Cont.) Appendix A

	Level 5	4	Level 3	2	Level 1
5.0			**ACCOUNTABILITY AND TRANSPARENCY**		
h. ☐	Sources of pertinent information (for example ratio analysis) are readily available instead of hidden	☐ ☐	Sources of pertinent information are not readily available but can be fairly computed	☐ ☐	Sources of pertinent information are mostly hidden and not easily computed
i. ☐	Notes on KLSE Listing and other regulatory requirements are sufficiently reported	☐ ☐	Notes on Listing and regulatory requirements are generally reported	☐ ☐	Notes on Listing and regulatory requirements are not reported
j. ☐	Notes on appointments of independent professional advisor(s) and service of company secretary are sufficiently disclosed	☐ ☐	Notes on appointments of independent professional advisor(s) and service of company secretary are fairly disclosed	☐ ☐	Notes on appointments of independent professional advisor(s) and service of company secretary are not disclosed
k. ☐	Notes on segmental reporting is sufficiently included in the financial statements	☐ ☐	Notes on segmental reporting is fairly included in the financial statements	☐ ☐	Notes on segmental reporting is not included in the financial statements
l. ☐	Notes on penalties and sanctions against or by the company are sufficiently disclosed in the annual report.	☐ ☐	Notes on penalties and sanctions against or by the company are fairly disclosed in the annual report.	☐ ☐	Notes on penalties and sanctions against or by the company are not disclosed in the annual report.
m. ☐	Very clear policy on the engagement of external auditors (is on rotational basis with 5 years maximum)	☐ ☐	Fairly clear policy on the engagement of external auditors	☐ ☐	There is no policy on the engagement of external auditors

(Cont.) Appendix A

		Level 5	4		Level 3	2		Level 1
5.0		ACCOUNTABILITY AND TRANSPARENCY						
n.	☐	Policy on relationships with external auditors are clearly spelt out	☐	☐	Policy on relationships with external auditors are fairly spelt out	☐	☐	Policy on relationships with external auditors are not spelt out
o.	☐	The annual report sufficiently discloses the company's policy on directors remuneration	☐	☐	The annual report fairly discloses the company's policy on directors remuneration	☐	☐	The annual report does not disclose the company's policy on directors remuneration
p.	☐	The annual report sufficiently discloses the quantum /amount of directors remuneration	☐	☐	The annual report fairly discloses the quantum /amount of directors remuneration	☐	☐	The annual report does not disclose the quantum /amount of directors remuneration
q.	☐	Notes on Board of Directors assessment of company's position are sufficiently disclosed	☐	☐	Notes on Board of Directors assessment of company's position are fairly disclosed	☐	☐	Notes on Board of Directors assessment of company's position are not disclosed